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No. 880.

In the Supreme Court of the United States

OCTOBER TERM, 1958

ROBERT F. ZEDDIES, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 228–251) are not officially reported. The opinion of the Court of Appeals (Pet. 1a–10a) is reported at 264 F. 2d 120.

JURISDICTION

The judgment of the Court of Appeals was entered on February 20, 1959 (Pet. 11a). A petition for rehearing was denied on March 30, 1959 (Pet. 12a). The petition for a writ of certiorari was filed on April 30, 1959. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Court of Appeals correctly affirmed the Tax Court's determination of deficiencies in income tax for the years 1944 through 1947 and the Tax Court's finding that a portion of the deficiency for each year was due to fraud with intent to evade payment of tax.

STATUTES INVOLVED

The pertinent provisions of Sections 54 and 293 of the Internal Revenue Code of 1939 and Section 7454 of the Internal Revenue Code of 1954 are printed in the Appendix, *infra*, p. 10.

STATEMENT

The Commissioner determined deficiencies in the taxpayers' income tax for the years 1942 through 1947 which, together with additions to tax for fraud under Section 293(b) of the 1939 Code, Appendix, *infra*, p. 10, amounted to $409,689.96. During the proceedings in the Tax Court the Commissioner conceded that the deficiencies for the years 1942 and 1943 were not due to fraud and that they were accordingly barred by the statute of limitations. Based on other concessions made by the Commissioner and adjustments which the Tax Court felt the evidence required, the deficiencies and penalties were redetermined by the Tax Court to be $292,784.44. In so determining, the Tax Court found that at least part of the deficiency for each of the years 1944 to 1947, inclusive, was due to fraud with intent to evade payment of tax. The decision of the Tax Court was affirmed by the Court of Appeals in all respects (Pet. 1a–2a, 10a).

For many years the taxpayer was a food broker and salesman in the Chicago area. Most of the time he represented a number of candy manufacturers who sold their products to retail grocery stores, paying his own expenses and receiving commissions for his services. This representation of candy manufacturers continued during the years in issue. During World War II, candy and the ingredients used in its manufacture were in short supply and were subject to price regulation by the Office of Price Administration. Manufacturers were limited to the pre-war prices and retailers' ceilings were computed by applying a percentage mark-up over cost. Throughout the period in issue the taxpayer was employed by the Kroger Grocery & Baking Company to procure candy for its retail sales. Kroger paid taxpayer a five per cent commission on candy thus supplied. In this connection, taxpayer frequently purchased candy in bulk lots and arranged to have it packaged in retail units, by one of several firms, which then re-sold it to Kroger (Pet. 2a–3a).

The deficiencies here in question arose from several sources. It was first determined that the taxpayer had failed to report substantial amounts of commissions received during the years 1944–1947. A portion of the unreported commissions for 1946 was falsely invoiced as sales of chocolate peanuts to the East India Nut Company, a packaging concern with which the taxpayer did considerable business. Another portion of unreported commissions was received by the taxpayer in 1946 and 1947 from Carol Lynn Products

Company, a candy packaging partnership in which he owned a one-half interest (Pet. 3a–4a).

In addition to unreported commissions, the taxpayer also made substantial profits from sales of candy during each of the years involved which he failed to report as income. Using his own funds, the taxpayer purchased bulk candy at wholesale prices from various manufacturers both in his own name and as Zenna Products Company. Part of the candy sold or traded was spoiled or unsaleable candy including some repurchased from Kroger under agreement. While the taxpayer received invoices from suppliers, furnished invoices to buyers and received the proceeds of the sales of such candies, he kept no formal records of the kinds, quantities or costs of candy. In addition to paying the invoice price for candy which he purchased, the taxpayer also made overceiling payments to manufacturers and brokers either in the form of cash or ingredients for candy manufacture. In the absence of adequate records or other evidence of the amounts so expended, the Tax Court determined from the record that the taxpayer made overceiling payments of $2,000 in 1944; $20,000 in 1945; $40,000 in 1946; and $10,000 in 1947. These payments were added to the cost of goods sold for each year and the profits from sales were accordingly reduced (Pet. 4a–5a).

On November 1, 1944, the taxpayer and Frank W. Brinkman formed a partnership to conduct a candy brokerage business under the names of Frank W. Brinkman & Associates and Carol Lynn Products, with the profits and losses to be shared equally be-

tween the taxpayer and Brinkman. This firm's operations resulted in substantial profits in 1945 and 1946 and a small loss in 1947, but the taxpayer reported neither the income nor the loss (Pet. 5a–6a).

Finally, the deficiencies in question arose because of the taxpayer's overstatement of business deductions during these years. The taxpayer claimed as deductions various business expenses incurred in the conduct of his operations including inventory losses, prizes for sales promotions, entertainment of buyers, travel and automobile expenses and expenses on account of slow moving or spoiled candy. A substantial amount of these deductions was disallowed by the Commissioner. Where justified by the proof, the Tax Court increased the amounts of allowable expenses, and sustained the Commissioner's determination in all other respects (Pet. 6a).

As evidence of fraud, the courts below found, in addition to the omissions and understatements themselves: that the taxpayer's returns for 1944–46 and 1947 were prepared by a lawyer and an accountant, respectively, from information supplied by the taxpayer which did not take into account various items of income; that the lawyer did not sign the returns because he believed there was insufficient substantiating data; that the taxpayer presented only meager data when requested by a revenue agent in 1947 to produce his books, records and documents in connection with an examination of his 1944 and 1945 returns, informing the agent that he had no income in addition to the commissions reported and that he was not engaged in any business other than as a candy broker;

that on reexamination of such returns in 1948, together with an original examination of his 1946–47 returns taxpayer again supplied only negligible data; that the taxpayer did not maintain adequate records of his sales of candy forcing revenue agents to obtain their information from the books and records of suppliers, customers, trucking companies and warehouses; that the taxpayer falsely claimed the original contribution of capital to the Brinkman partnership was his children's money and that the income of that firm belonged to them (Pet. 7a–8a).

ARGUMENT

On the taxpayer's petition, the Tax Court redetermined and substantially reduced the deficiencies and penalties determined by the Commissioner. As conceded by the taxpayer (Pet. 17) and as recognized by the Court of Appeals (Pet. 9a), the questions presented on review of the Tax Court's decision were largely factual in nature. The Court of Appeals found that the findings of the Tax Court were fully supported by the evidence of record (Pet. 9a). The opinions of the Tax Court (R. 239–251) and the Court of Appeals (Pet. 1a–10a) indicate that each court fairly and impartially reviewed the entire record. The factual questions involved are inappropriate for further review in this Court. *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 51. The finding of fraud is also a factual finding which will not normally be reviewed anew. *Helvering* v. *Kehoe*, 309 U.S. 277.

Similarly, the legal rules applied below are well settled and there is no conflict of authority. The

taxpayer's concern (Pet. 10–12) that the court below erred in applying the rule of *Helvering* v. *Taylor*, 293 U.S. 507, is not well founded. That case holds that the burden of proof imposed upon a taxpayer is satisfied when he establishes that the Commissioner's determination is arbitrary, or based upon a formula which could not produce the correct amount of the tax liability, and that it does not extend further to require the taxpayer to prove the amount of tax actually due. This rule has no application to cases such as this where both the Tax Court (R. 228–251) and the Court of Appeals (Pet. 9a) considered and approved the method used by the Commissioner in computing the deficiencies. Contrary to taxpayer's suggestion, *Helvering* v. *Taylor, supra,* and related cases, do not require the Tax Court to ignore the Commissioner's determination in its entirety if the proof shows that a correction may be required as to specific items. As the Court of Appeals remarked (Pet. 10a):

> The rule in *Helvering* v. *Taylor, supra,* does not prevent the Tax Court from exercising its function, in a proper case, of redetermining the deficiencies assessed by the Commissioner.

See also, *Rogers* v. *Commissioner*, 248 F. 2d 452, 453 (C.A. 7); *Clark* v. *Commissioner* (C.A. 9), decided April 30, 1939 (59–1 U.S.T.C., par. 9430).

The allegation (Pet. 12–13) that the Tax Court's finding of fraud was based upon the presumptive correctness of the Commissioner's determination, and therefore was erroneously affirmed below, is equally misconceived. The evidence establishes that there

was a deficiency for each of the years in question and that a portion of the deficiency in each year was due to fraud with intent to evade payment of tax. This evidence includes, but is not limited to, proof that the taxpayer did not report substantial profits from candy sales, did not keep adequate books and records, did not cooperate with investigating officers, concealed items of commission income as sales, and failed to report either membership in or profits and losses arising out of a partnership of which he was a member, falsely claiming that this interest was held in trust for his children (Pet. 7a–8a).

Finally, the taxpayer questions (Pet. 13–14) whether the courts below could lawfully estimate amounts expended by the taxpayer in making over-ceiling payments to candy manufacturers, an action which actually served to reduce rather than increase his taxable income. In performing its function of redetermining the deficiencies in question, the Tax Court was faced with a situation where it believed that the taxpayer had made such payments, but it could not determine from the taxpayer's evidence the amounts thus expended (R. 244–247). Such a situation called for the exercise of the Tax Court's best judgment under the familiar principle of *Cohan* v. *Commissioner,* 39 F. 2d 540 (C.A. 2), and the Court of Appeals was clearly correct in affirming the estimates thus made. While it is true that the *Cohan* case involved the amounts of deductions rather than expenses includible in cost of sales, the principle there announced is of broader application and has not been limited to determining the amounts of deductible

items. See *Clark* v. *Commissioner, supra; McKelvey* v. *Commissioner,* 246 F. 2d 609, 613 (C.A. 3). At all events, its application here benefited taxpayer, and he is hardly in a position to complain.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * * *

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * * *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

Internal Revenue Code of 1954 (26 U.S.C., Supp. V):

SEC. 7454. BURDEN OF PROOF IN FRAUD AND TRANSFEREE CASES.

(a) *Fraud.*—In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary or his delegate.

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